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BEFORE THE

SUBCOMMITTEE ON CIVIL SERVICE, POST OFFICE,
AND GENERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

RETIREMENT CONTRIBUTION REQUIREMENTS
FOR NEW FEDERAL EMPLOYEES

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear today to present our views on the effects of temporarily requiring new Federal employees to contribute to both social security and the civil service retirement system. We are pleased that your committee has undertaken these hearings to remedy this situation. We have been concerned that the extra contributions would place the Government at a competitive disadvantage in recruiting and retaining employees because they would result in a substantial reduction in take-home pay. While employees in the private sector must pay social security taxes, few are required to contribute to their employer-sponsored retirement programs.

Most employees in the civil service system must pay 7 percent of their salary into the retirement fund. Some participants contribute even higher amounts, and all employees pay an additional 1.3-percent medicare tax. Beginning in January 1984, newly hired Federal employees and former employees rehired after a break in service of 1 year or more will also be covered by social security. Therefore, in addition to retirement fund contributions and the medicare tax, they will be required to pay social security taxes of 5.4 percent in 1984 and 5.7 percent in 1985. While medicare and social security taxes currently apply only to the first $35,700 of annual salary, nearly all new employees will receive salaries below this level. Thus, they will be contributing a total of about 14 percent of their salary to these programs until a new retirement system to supplement social security is established. It is anticipated that the new system will not be in place until sometime in 1985.

We issued a letter report to the Senate Committee on Governmental Affairs on August 31, 1983, which highlights our concerns and discusses some options to ameliorate the problem. I would like to submit a copy of that report for the record and summarize the options.

It is difficult to predict at this time what a new supplemental retirement system will provide or how it will be implemented. Presumably, it will retroactively cover all service by new employees after January 1, 1984. We also assume that any contributions new employees make to the civil service system, during the period of temporary coverage, that are greater than the amount required by the new system would be refunded.

The Office of Personnel Management (OPM) estimates that by the end of 1985 a total of 385,000 Federal employees could be affected by the dual contribution requirement. OPM estimates these employees will contribute about $470 million to the civil service retirement fund during this 2-year period, but only a few of them are expected to receive any civil service benefits from their contributions. This is because new employees must have 5 years of civilian service to be eligible for disability benefits and must have been employed at least 18 months before their survivors could receive death benefits. Social security requires coverage of up to 5 years, depending on the employee's age, for disability benefits and 18 months for death benefits.

Thus, none of the new employees would be eligible for disability benefits from the civil service system and only those hired early in 1984 would be eligible for civil service death benefits. Rehired employees could be eligible for more benefits because of their prior Federal service. Overall, OPM estimates that civil service disability and death benefits will be paid in 750 instances, and such payments are estimated to be about $500,000 in 1984 and $2,900,000 in 1985.

The extra contributions to be required of new employees will cause a substantial reduction in their take-home pay. This could adversely affect the Government's recruiting and retention efforts. Officials in the five departments and agencies we visited were very concerned that the higher retirement contributions would place the Government at a competitive disadvantage especially in those occupations where the Government already has to pay special salary rates to compete with the private sector. In 1982, agencies were paying about $93 million annually in salary supplements over and above regular rates to 34,300 such employees.

In view of the limited benefits that employees will derive from temporarily contributing to the civil service system and the problems the increased contributions may cause, we evaluated several alternatives that could resolve this situation. These alternatives were:

1. Provide a temporary tax credit to Federal employees covered by the social security system for the amount of their contribution to the civil service system.

2. Provide no civil service coverage; therefore, no contributions to the civil service system would be required.

3. Provide temporary civil service coverage without requiring employee contributions but with a 100-percent social security offset against any civil service benefits received.

4. Provide for voluntary temporary participation in the civil service system by new employees.

Under each of these alternatives, employees' service credits would be transferred to the new supplemental system when it is established.

I would now like to discuss the alternatives in more detail along with the advantages and disadvantages of each one.

Tax credit

One way to alleviate the impact of greater retirement contributions would be to provide the new employees an income tax credit for their civil service contributions during the 2-year period. Bills have been introduced in the House of Representatives (H.R. 3371) and the Senate (S. 1522) to permit such credits. However, timing of the tax credit could be a disadvantage, inasmuch as the employees may not benefit from the credit until the following year when they file their tax returns.

This alternative would continue full employee and employer contributions to the civil service trust fund. Employees would have greater disability and death benefits than those hired prior to 1984 because of the dual coverage, but would have contributed less because of the tax credit. Since the proposed bills do not change the refund provisions of the civil service system, employees could receive not only the tax credit but also a refund of their contributions if they later left Government service.

No civil service coverage

Under this alternative, the social security program would provide disability and survivor benefit coverage for new employees but, depending on individual circumstances, benefits could be more or less than civil service benefits. No employee or employer contributions to the civil service system would be required.

This alternative avoids any duplicated benefits and the potential administrative burden of refunding employee contributions if a noncontributory supplemental plan is later established or the contribution rate under the new plan is lower.

Recruiting may be more difficult than under other alternatives because of the uncertainty about the level of future retirement benefits. Also, this alternative would generally provide lower disability and death benefits, especially for rehired employees who might otherwise qualify for civil service benefits because of prior Federal service but who may not have sufficient service to qualify for social security benefits.

Social security offset

This alternative would provide employees coverage under both systems, but civil service benefits would be reduced by the amount of any benefits received from social security. While employee contributions to the civil service system would not be required, agencies would continue to make civil service contributions which would be used to finance civil service benefits for these employees.

The alternative assures disability and death benefit coverage comparable to that provided employees hired before 1984, but at less cost to new employees. However, it creates some administrative burden in computing the social security offset. It does avoid the potential administrative burden of refunding employee contributions if a noncontributory supplemental plan is later established or the contribution rate under the new plan is lower.

Voluntary participation

While all new employees will have social security coverage, this alternative would permit those employees who desired greater coverage to participate in the civil service system. Participating employees and their agencies would each be required to make the regular contributions to the civil service system.

This alternative would give participating employees more coverage than that provided employees hired prior to 1984. While it would give the individual the responsibility for determining the adequacy of coverage, it would be very costly for the limited additional coverage most employees would receive.

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In summary, Mr. Chairman, unless the current law is changed, new employees will contribute almost $500 million to the civil service system, but only a very small number will receive any benefits from those contributions before the new system is established. Moreover, the dual contributions will reduce employees' take-home pay making recruiting and retention of quality individuals much more difficult. In some cases, special pay rates might have to be increased or paid to more employees. Resolution of this problem prior to January 1, 1984, would relieve new employees from the burden of contributing to both social security and the civil service system.

I would be pleased to answer any questions you may have.